

Current and future issues in the Aruban labor market

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prof.dr. Ruud H. Koning

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Current and future issues in the Aruban labor market

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November 19, 2006

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ABSTRACT

The Aruban economy has seen tremendous growth since the mid 1980's. This growth has been fueled by importing labor: cumulative net migration between 1991 and 2000 has been 18215 people, which in fact exceeds net employment creation over that same period. Net migration has been positive since 1988, which has, among other things, resulted in a significant increase in the population of Aruba. Recently, the government has changed the rules to obtain working permits. Also, construction of new hotels is taking place on the island. In this paper we explore the consequences of these developments, and we give some options for preventing decreasing growth to a lack of labor supply.

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1 INTRODUCTION

In the spring of 2006, the Aruba Hotel and Tourism Association (AHATA) has contacted ABC Advies to have a report written on the Aruban labor market. The reason for this request is the perceived shortage of labor on Aruba, which affects labor-intensive industries as tourism perhaps more than other industries. In a previous report, I indicated that the permit system was not very flexible and could be a threat to continuous growth of the economy (Koning, 1998). In this report, both current issues and medium term issues should be discussed, and possible solutions for bottlenecks found should be discussed. AHATA has formulated the following short-term questions:

- S-1. Produce tailored labor market information for Aruba and its key industries (tourism, construction/builders, refinery).
- S-2. Create a snapshot of the existing labor market shortage which exists on the island.
- S-3. Describe the lengthy and bureaucratic process to obtain or renew work permits and its effects on doing business in Aruba.
- S-4. Identify the social-economic consequences if no action is taken to address the situation.
- S-5. The effects of a tight labor market on the daily operation of business and Aruba's need to deliver high-end service and product.

Question S-1 is to some extent discussed in section 2, but an in-depth quantitative analysis of the labor market is beyond the scope of this study. The CBS provides some information (see also section 2), but that information is limited to aggregates. In Appendix A, I list a number of research proposals, one of which refers to this issue. Issues S-2 to S-5 will be addressed in this report, although issue S-4 will be dealt with cursorily only (see also Appendix A).

Also, AHATA formulated this list of questions relating to medium/long term issues:

- M-1. Study the social and economic challenges being faced by Aruba.
- M-2. Justification that a strategically planned labor market is crucial in counter-acting the social-economic challenges.
- M-3. Portrayal of the disparity between demand and supply of the labor market of Aruba and the effects this has on the economic development of the island.

- M-4. Identifying potential labor market strategies with the least amount of burden on the social infrastructure of the island.
- M-5. Pursuing labor market strategies should also eliminate the divergence which exists between the demand and the supply of adequate labor.
- M-6. The position paper should include recommendations and propositions for the next steps to be taken by the private- and public sector in achieving a solid and well-planned labor market which would secure the continuation of sustainable economic development.
- M-7. The position paper should further serve as a starting point for a constructive dialogue by key stakeholders aimed at the development of an effective labor market strategy to face the social-economic challenges.
- M-8. The study should provide information for strategic policy development with regards to the labor market and economic development. There needs to be an integrated approach towards future economic development/projects and the labor needs of the island.

Issue M-1 (to some extent together with question S-4 above) warrants a full study. In this paper, we touch briefly on the social-economic challenges faced by Aruba. A complete study would have to compare these issues between Aruba and its main competitors to determine whether these are unique to Aruba, or not. Items M-2 to M-6 are discussed in this paper. In particular, section 5 discusses policy recommendations explicitly. In fact, I consider that to be the most important section of this report.

I hope that the report provides useful information, and that the analysis in this paper helps the reader seeing current developments in perspective. In that case, issues M-7 and M-8 are dealt with as well.

The remainder of the report is set up as follows. In section 2 I provide an analytical framework and some quantitative information on the labor market. Developments are identified both looking back in time, and by using projections into the future. From that section, it will be clear that there is a labor shortage in Aruba, so in section 3 I discuss the process to obtain a work permit for non-Aruban workers (thereby explicitly answering question S-3 above). Section 4 considers some possible labor market policies. Immediate and middle-term policy recommendations are given in section 5.

2 DEMAND AND SUPPLY ON THE LABOR MARKET

The Aruban economy consists of four main pillars: the construction industry, the Valero oil refinery, tourism, and the government. All four sectors produce goods

and/or services, using scarce resources as their primary inputs: labor, land, capital, and technological knowledge. Capital and technological knowledge are to a large extent importable, and indeed, that is what happens in Aruba. Labor and capital are more or less fixed, certainly in the short run.

Even though it is convenient to analyze the labor market as being one market where a homogeneous good is traded (labor), that is not a useful approach. Labor supply and labor demand have multiple dimensions. In a case such as the Aruban labor market, it is particularly relevant to distinguish between different segments. One can distinguish between the following segments:

- elementary positions, unskilled and low-skilled labor (for example, maids, cleaners);
- lower managerial positions, clerical positions (for example, supervisors, nurses);
- highly qualified positions (for example, general managers, top civil servants).

Such a distinction would roughly correspond to a segmentation based on the level of schooling required for a job. Thinking of the labor market as a segmented market is important, as labor supply in particular is not substitutable between segments. A nurse cannot be replaced by two cleaners, as the latter don't have the skills necessary to perform the duties of the former. It is unlikely that even after a period of training that would be the case. This implies that there is not one labor market, but multiple labor markets. The fact that there are different segments on a labor market also implies that one cannot have one single labor market policy. Shortages in one segment cannot be filled by surpluses from other segments.

Labor demand has increased markedly during the last decade. Net employment creation over the period 1991-2000 has been 13504 jobs (Central Bureau of Statistics, 2005). Labor supply has been unable to keep up with that growth. This increased demand was partly filled by Arubans that were out of a job (mainly because of the closure of the refinery), but most of this demand was filled by foreign workers. In figure 1 we graph net migration over time. Cumulative net migration between 1991 and 2000 has been 18215 people, which in fact exceeds net employment creation over that same period. Net migration has been positive since 1988, which has, among other things, resulted in a significant increase in the population of Aruba (figure 1, lower panel). The population remained more or less stable between 1972 and 1988. Between 1988 and 2005 the population increased from 60 thousand people to slightly more than 100 thousand people, an average yearly growth rate of 3%. As a result of successful development of tourism, the average number of tourists per day has increased to approximately 16 thousand.

Of course, there will be more tourists on the island during the high season. This enormous growth in the population has increased population pressure on the island, resulting in a steady increase of the population density. It is unlikely that any physical or social infrastructure can cope with such a population growth, so, for example, pressure on schooling and the health care have increased, as has road congestion. The number of beds in de Dr. Horacio Oduber Hospital has remained constant between 2000 and 2005 (Central Bureau of Statistics, 2005, p. 13).

This increase of the population has been caused by immigration due to increased labor demand. Labor demand has increased particularly in the construction and tourism sector. These sectors are labor-intensive, so growth in these sectors imply additional labor demand. In the period 1985-2005, the value of construction has increased almost five-fold from Afl. 42.7 million to Afl. 210.1 million. Growth of the tourism sector is evidenced by the growth in the number of rooms and the number of stayovers.

Unemployment in Aruba is not measured on a continuous basis by a government agency. The census of 2000 provided an estimate of unemployment of 6.9%, which has not been updated since then. The Central Bank of Aruba provides their own estimate of unemployment yearly. According to their data, unemployment has varied between 6% and 8% since 2001. Their current estimate is an unemployment rate of 6.9%. Unfortunately, no data are available of unemployment rates by segments of the labor market. Moreover, it is not clear to what extent unemployed are available on the labor market. Skills offered may differ significantly from skills demanded, or skills may have deteriorated over time. Moreover, it is not clear whether there is movement between segments: will a better paid clerk who became unemployed eventually settle for a low-skilled job with lower wages? Detailed information concerning the skills offered by unemployed or asked by potential employers is not available, Central Bureau of Statistics (2004a, p. 14). In that report, the CBS makes the case that probably 42% of the unemployed registered in the 2000 census are well qualified for work. The largest group in that survey is unemployed 'for other reasons', it is not clear to what extent they could be an addition to the labor force.

According to the Central Bureau of Statistics, total employment in 2006 is estimated at 48207 persons, and the total population is estimated at 102923 persons. The aggregate employment rate is 46.8%, which is slightly lower than the aggregate employment rate in The Netherlands in 2005 (50.2%). We note that the child care facilities in The Netherlands are more elaborate, which may be one explanation of the higher rate in The Netherlands. We also note that the participation rate of women has increased significantly from 26.7% in 1960 to 56.7% in 2000 (Central Bureau of Statistics, 2004a, p. 16). Compared to other countries in the Carribean, the participation rate is already relatively high. Even though the rate may continue to increase over the next ten years (especially when well-educated

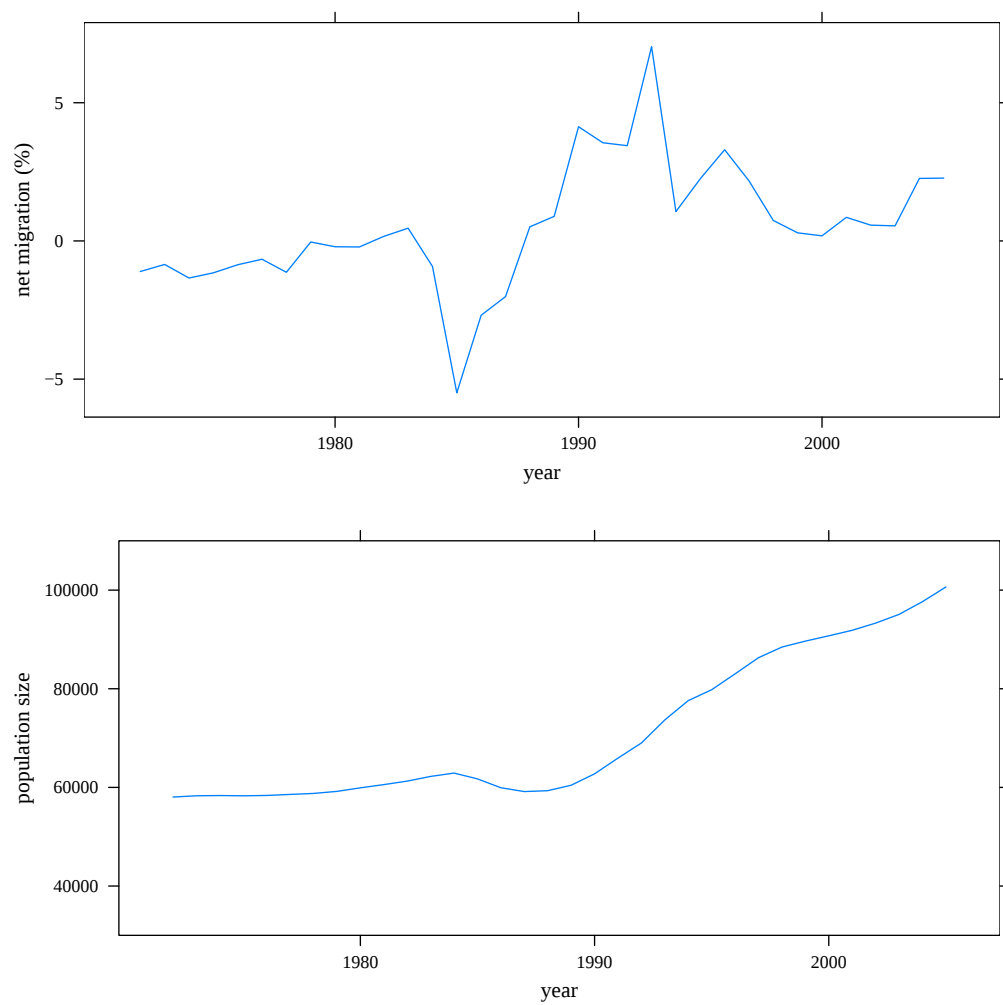


Figure 1: Net migration (upper panel) and size of the population (lower panel) over time (Central Bureau of Statistics, 2005)

young women are entering the labor market), it is unlikely that the fast increase of the 1960-2000 period will continue. Increased female labor force participation will increase demand for day-care and after school care for their children. Such facilities can be offered either by employers or the government. Also the government may facilitate such facilities by tax deductions and other fiscal measures.

In the medium and long run, labor supply in Aruba will fall short of labor demand. The survey in the spring of 2006 by AHATA showed that projects currently under way will increase labor demand by at least 4000 persons during the next four years. At this moment, the labor market is unable to absorb such a shock. In the longer run, even more high profile construction is expected (for example, a new Ritz-Carlton hotel), that will increase labor demand even more.

Labor supply is, in the long run, a limiting factor on the growth potential of the Aruban economy. Central Bureau of Statistics (2004b) provides population projections over the period 2003–2023. Interestingly, they provide their scenario's based on expected (or desired) economic growth. The relation between the size of the economy as measured by GNP and the size of the population has been very stable and predictable over time. They use this relation to estimate the size of the population that is necessary to sustain a certain economic growth. This growth can be generated either by increases in the productivity of labor, or an increase in the volume of the labor force. Considering the fact that Aruba is a service economy where it is difficult to increase labor productivity, most of the growth will have to be realized by an increase in the volume of the labor force. From these scenario's, it is clear that the Aruban population will not be able to maintain growth in the long run, for two reasons. First, as in many economies, the population is aging so increasingly more people are leaving the labor force into retirement. Secondly, fertility has dropped very rapidly, so the addition to the labor market is decreasing. These two developments together imply that Aruban labor supply will not be enough to sustain economic growth in the medium term. If no measures are taken, there will be beautiful hotels in Aruba, but not enough people to run them. The solution to this problem has been to import labor: approximately 50% of the Aruban labor force is non-Aruban. The largest groups are workers from Colombia, Venezuela, the Netherlands, the Philippines, and the Dominican Republic (Directie Arbeid & Onderzoek, 2005). Inflow of foreign labor is regulated, so in the next section we discuss the process employers have to follow to acquire a residence permit for foreign workers.

3 WORKING AND CONSEQUENCES OF THE LTU

Residence permits are regulated. Foreign workers need a permit to be able to work legally. Workers who have such a permit, are eligible for medical care under AZV and their children are eligible for free schooling.

Economic theory offers two views on regulation. The first view is the public interest view, where the government or a regulatory body acts in the best interest of the general public. Failures on the labor market would be a rationale for the government to intervene. Examples of such failures could be discrimination against certain groups, or external effects that are not priced properly. In the current case, external effects could be an overcrowded health system, or overcrowded schools. The other view on economic regulation is the private interest view, advocated by Chicago economists as Stigler (1971) and Posner (1974). In this view, regulation is a product, and as with any product, there is demand and supply. Government supplies regulation, and other economic actors demand regulations. In this case, the gains of regulation accrue to other parties than the general public. Examples of beneficiaries in this case may be civil servants who are able to keep a well-paid job, or a trade union who is able to keep wages artificially high.

In a small society as Aruba, the private interest view may be particularly relevant. The distance between economic actors and the government is small. It is easy to exert influence on the government. In fact, a member of the government may have been such an actor just one or two years ago. Also, the size of the government is small, so at times there is hardly any *de facto* distinction between executive powers of the government and legislative powers.

As far as labor market policies are concerned, it is rather easy to restrict access of foreign workers by closing access to the island. This is more difficult for continental countries. In both cases, it is more difficult to regulate the labor market after entrance when the foreign workers have been working for some time already.

During the interviews, different explanations were given for the restrictive labor market policy, most of which are more compatible with the private interest view of regulation than with the public interest view.

- ‘Aruba for the Arubans’. Politicians follow the popular vote, and restrict access by foreign workers to appease voters, who presumably fear downward pressure on wages when foreign labor enters the market.
- The Dutch government wants a restrictive policy. After five years, foreigners with a permit can apply for Dutch citizenship. The Dutch government wants to restrict this way of acquiring Dutch citizenship.
- The social and physical infrastructure cannot cope with a large inflow of new people. Not that this argument would also apply to Arubans. Related to this argument is the argument that foreigners use more social infrastructure than that they pay for through income taxation.
- The government wants to create scarcity on the labor market so that wages increase. First of all, an increase of wages can be claimed as a success at the

next elections. Secondly, if wages in the private sector would increase, the private sector would become a more attractive employer (compared to the public sector). This would enable the government to reduce its labor force.

The third explanation can be substantiated to some extent by empirical arguments. Most foreign workers work in relatively low-wage jobs (Directie Arbeid & Onderzoek, 2005). As funding for health care (AZV) is income dependent, these workers will contribute only a small amount. In fact, if one compares average per capita medical consumption with the amount of premium paid for the AZV, roughly 70% of the workers are net consumers of the health care system, and 30% are net contributors.

Obtaining a work permit for a foreign employee takes a long time. First, a firm posts a vacancy, and registers the vacancy with DAO. If no suitable candidate is found, DAO provides a notice with this fact. Within three months the firm can apply for a residence permit for a foreign worker with DIMAS. A complete application with DIMAS is difficult due to the paper work involved, and it is not available to apply using electronically. Upon receipt of the application, DIMAS will ask advice from DAO, focusing on two issues:

- Is an Aruban available who is registered as being unemployed with DAO, and who is qualified for this job?
- Is the wage offered for the job reasonable when compared to the qualifications asked?

For the first issue, it is important that the job description is as precise as possible. Some firms complain that DAO sends people who are not qualified at all for the job, resulting in a loss of time. DAO reviews the second question by comparing the wage offered with the wages offered for government jobs with the same qualifications. This policy exerts an upward pressure on the wages of low-skilled jobs, as the government pays better for these type of jobs than the private sector. After obtaining advice from DAO, DIMAS makes a decision.

This policy of granting work permits is identical for all types of labor. However, both DIMAS and DAO acknowledge that the labor market is segmented. We distinguish between the following segments:

- Lower segment, there is hardly any Aruban labor supply;
- Middle segment, there is enough Aruban labor supply;
- Top segment, some Aruban labor supply but foreign investors like to bring in their own people.

Clearly, by having a 'one-type-fits-all' labor market policy, top managers and, say, cleaners are treated identically. Their values for the economy are different, as is clear from the difference in wage levels. It seems reasonable to have different policies and requirements by segment, and the concept of segments can be made operational by looking at wages offered.

The process of acquiring and processing work permits is lengthy, and costly. Besides the monetary costs of an applying (AFL. 65) and the cost of the permit itself once granted (AFL. 1200), there are also costs to the employer filing the application (he has to fill in paperwork, etc.), and there is a lot of pressure on government services to process the applications promptly.

4 ALTERNATIVE LABOR MARKET POLICIES

In section 2 we concluded that foreign workers are needed to sustain growth, in the previous section we discussed the difficult process to acquire work permits for those foreign workers. In this section we discuss a number of labor market policies, that may help to alleviate the shortage in the short, medium and long run. The first policy is aimed specifically towards to hotel sector.

1. Many young entrants on the labor market find it unattractive to work in the tourism industry. Wages are low, hours are long, and secondary benefits are non-existent or poor. Whether or not these complaints are justified, the perception is there and reduces labor supply to the tourism industry. Hotels have been unable to hire school children for part-time or summer jobs. Considering the tight labor market situation, it is necessary for the hotel sector to improve its image, also by improving primary and secondary job benefits. Wages should be increased, but also other benefits could be considered as after-school care for children, or transport from San Nicolas to the hotels.
2. Participation of especially women and elderly in the workforce can be increased. However, this requires additional measures as after-school care for children, and schooling for elderly.
3. The tight labor market situation is a direct consequence of continuous growth of labor-intensive sectors of the economy. Ongoing construction of new hotels has led to and will lead to increased demand for labor. This type of labor is low-wage labor, and it is very difficult to increase labor productivity in the tourism sector. Aruba will be stuck in a low-wage equilibrium. Expansion of the tourism sector is a choice, not a given force of nature. Economic growth and the contribution of the tourism sector to GDP is not maximized by maximizing the number of tourists on the island. Ever more tourists

will decrease the quality of living and the quality of tourism. Tourists expect clean beaches and uncongested roads. Instead, they risk ending up on crowded beaches, as long as they are not in a traffic jam. A moratorium on the building of new hotels should be considered, and older facilities should be upgraded.

4. Competition is limited on Aruba. This is partly due to the scale of the island, but also to vested interests and close links between voters and politicians. The member of parliament today may be a business man in need of a favor tomorrow. However, this lack of competition reduces national output, as factors of production are not used where they are most efficient. Aruba would benefit from anti-trust legislation, that is enforced.
5. Growth without foreign labor is hard to imagine. Foreign labor has been the engine of growth during the last decades. If one decides to restrict access to the labor market, the process to obtain permits should be transparent so that the costs of the system are minimized. One can make a strong case for allowing Dutch nationals to be given an immediate residence permit, as is the case in Curacao. Wage differentials between Aruba and the Netherlands have decreased over time, so it has become more attractive to Arubans (and Dutch) to work on Aruba. Since these persons have the Dutch nationality already, the second explanation of the restrictive labor market policy cannot hold (page 7).

5 POLICY RECOMMENDATIONS

TOURISM SECTOR The tourism sector is perceived as an unattractive employer. There are limited opportunities for taking evening courses due to the shifts that are scheduled at different times. Tourism is a 24/7 industry, which makes it difficult to make time commitments at fixed times during the week. Such perceptions by the potential labor force should be measured over time, and in this case the perception, whether correct or not, has to be improved. This will require some creativity from the sector, as well as willingness to pay.

TOURISM SECTOR DIMAS is willing to listen to the hotel industry, and understands that some employees are very important for hotels. AHATA should be the voice to DIMAS so that communication is improved. Importance of a vacancy can be measured unambiguously by the salary offered.

EMPLOYERS Ties between the government and employers need to be improved. The government is not an exogenous entity, as it is considered by many employers at this moment.

EMPLOYERS There may be a business case for the tourism sector and other employers (as Valero, for example) in developing an ICT system for DIMAS. At this moment, real paper is transferred from one desk to another. Costs of such a system could be well worth the savings.

GOVERNMENT At this moment, not enough data are available to develop proper labor market policies. Every other year a census should be held, and unemployment should be measured on an ongoing and consistent basis.

GOVERNMENT Responsibilities between DIMAS and DAO should be clearly delineated. Also, a system of quality control should be developed. Transparency should be improved, backup up by aggregate statistics that are publicly available.

GOVERNMENT Communication between different parties on Aruba is not well established. The suggestion of the Chamber of Commerce for a Tripartite Commission should be followed (Kamer van Koophandel, 2005).

GOVERNMENT Inflationary pressures are looming: import duties, imposition of a turnover tax, upward pressure on wages, expected tax increases because of the government deficit all are contributing to an (increase of) inflation. Inflation will increase interest rates (hence reduce investment) and cause devaluation of the florin.

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A RESEARCH PROPOSALS

In this Appendix I suggest three topics of further research, that could be carried out by a student for a MA-thesis.

A.1 TAILORED LABOR MARKET INFORMATION

The labor market of Aruba is not a homogeneous labor market: different segments can be distinguished. Within each segment, demand may or may not exceed supply. Following for example the segmentation suggested on page 3, detailed projections of demand and supply can be made using the labor force planning, the AHATA-survey, and planned construction. Also, it may be possible to extrapolate data from the census of 2000, using more recent data of the population composition.

A.2 GROSS WAGES, NET WAGES, AND SECONDARY BENEFITS IN THE PRIVATE AND PUBLIC SECTOR

A complaint that is heard frequently (and not only on Aruba) is that government employees are paid better than corresponding employees in the private sector. However, it is surprisingly difficult to find any hard data on this comparison. In this proposal, detailed comparison is made between both monetary and non-monetary benefits of both types of jobs. Also pension entitlements should be taken into account. It makes sense to make this comparison at different levels in the government, following the segmentation of the labor market discussed on page 3.

A.3 COSTS OF THE RESIDENCE PERMIT SYSTEM, BUSINESS CASE ICT DEVELOPMENT

There are only limited quantitative data available on the time it takes to get a LTU. Moreover, there are no quantitative data available of all costs incurred (see also page 9). Measurement of the monetary and non-monetary costs will indicate where most savings are possible.

B LIST OF INTERVIEWED PEOPLE

During the preparation of this report, I received information from AHATA, and I also talked extensively with the following persons:

- M. Balkestein, Central Bureau of Statistics, L.G. Smith Blvd. # 160, Sun Plaza Building Third Floor, Oranjestad, www.cbs.aw.
- C. Balkestein-Ecury, Department of Economic Affairs, Commerce & Industry, L.G. Smith Blvd. # 160, Sun Plaza Building Second Floor, Oranjestad.
- G. Croes, Centrale Bank van Aruba, J.E. Irausquin Blvd. # 8, PO Box 18, Oranjestad, www.cbaruba.org.
- E.E. De Cuba, Personnel Services, Sabana Blanco 40, Oranjestad.
- Drs. Ing. H.I. Diaz, Beleid, Onderzoek en Planning, Directie Sociale Zaken Aruba.
- M. Geerman-Esguerra, Divi Resorts, J.E. Irausquin Blvd. # 41, Oranjestad, www.diviresorts.com.
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